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Research Update:

German Power And Gas Co Uniper Upgraded To 'BBB' On Reduced Event Risk And Strengthening Business Risk; Outlook Stable

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Overview

- Uniper's earnings stability and profitability have improved in our view, and the company retains a strong financial position, providing financial headroom.
- The risk that Fortum's likely acquisition of 47% of Uniper would have a negative impact on Uniper's credit quality has reduced, in our view.
- We are therefore raising our long-term rating on Uniper to 'BBB'.
- The stable outlook reflects our assumption that Uniper's independence, strategy, and financial policy would not materially change because of the Fortum acquisition, and that its adjusted funds from operations to debt will remain above 55%, and adjusted debt to EBITDA be no higher than 1.7x.

Rating Action

On April 27, 2018, S&P Global Ratings raised its long-term issuer credit rating on Germany-based power and gas company Uniper SE to 'BBB' from 'BBB-'. The outlook is stable.

The ratings on Uniper's senior unsecured debt were also raised to 'BBB' from 'BBB-'.

Rationale

The upgrade follows our view of Uniper's business risk having strengthened, and the reduced risk of a negative impact on its credit quality from the likely 47% acquisition by Finnish power generation company Fortum Oyj.

In February 2018, Fortum announced that 47.12% of Uniper's shareholders had accepted Fortum's voluntary public takeover offer of Uniper, of which 46.65% is E.ON SE's share. Fortum's acquisition is subject to regulatory approvals, but we currently assume that these will be obtained. Fortum's offer of €22 per share values the 47% stake in Uniper at about €3.78 billion. In 2017, Uniper generated S&P Global Ratings-adjusted EBITDA of about €2.1 billion, which we forecast will decrease to €1.6 billion-€1.8 billion in 2018-2019.

We note that under German law, for Fortum or any other shareholder to gain immediate full control over the supervisory board and Uniper without any blocking minorities, it would need to own more than 75% of the company or control more than 75% of the representation at the annual general meeting. Although with 47% ownership Fortum could be in a position to nominate a new supervisory board, such a moment would come only once the term for existing supervisory board members has run out in 2022. Fortum has also declared its intention to support Uniper's management's stated strategy, while also seeking close cooperation between the two companies for value creation opportunities.

Fortum has further declared its support for Uniper's proposed dividend of €0.74 per share for 2017. We also understand that two activist funds have bought sizable stakes in Uniper. Although we assume that these funds would look for good returns on their investments, we have so far no indication that they would propose any material change in Uniper's current operational or financial strategies. Our base-case assumption is therefore that Uniper would continue operating as an independent company, and that the changes in ownership would not materially impair Uniper's credit quality.

We also do not factor into our base case any synergies that could emerge from an industrial partnership with Fortum. At the same time, we will monitor closely any signs or actions from Fortum or any other material minority shareholders that we believe could result in deviations from Uniper's stated financial policy and financial position. Such deviations could, for example, take the form of a higher growth rate in net investments or larger dividends than we currently envisage for Uniper's modest financial risk profile.

We have reassessed Uniper's business risk profile to satisfactory from fair, as we believe the company's earnings stability and profitability has gradually improved over the past couple of years. This is due to a recovery of power prices primarily in Nordic countries, and Germany, but also due to the company's internal measures, such as cost savings, renegotiations of unfavorable gas contracts, and the sale in late 2017 of the Russian gas field Yuzhno Russkoye. We assess, however, that Uniper is placed at the lower end of the business risk category, and is weaker than peers such as Fortum, Statkraft, Verbund, and Örsted, which all have higher shares of renewables generation, and less exposure to Russia and commodities trading.

The recent recovery of commodity prices has supported an increase of power prices in Uniper's main markets, notably in Germany where future prices increased to around €36-€38 per megawatt-hour (/MWh) in April 2018 from about €20/MWh in the first quarter of 2016. Also in the Nordics, future prices have increased, now indicating a level of €28-€30/MWh, up from below €20 just a couple of years back. However, the benefits to Uniper will only be gradual, because a large chunk of Uniper's generation portfolio has been price hedged or is under long-term contracts. Although we view Uniper's thermal generation portfolio in Germany as exposed to political decisions to reduce carbon emissions, we note that large part of Uniper's German generation is gas, which potentially can benefit from future forced coal plant closures, by being a necessary complement to the increased renewables generation in the country. Uniper's generation portfolio also takes advantage of the reduction of taxes on nuclear and hydro generation in Sweden, and from successful bidding in U.K. market auctions, resulting in fixed prices ranging between £7 and £23 per kilowatt until 2021.

We further take into account that in 2016, Uniper renegotiated its gas contracts with Gazprom, derisking its long-term gas supply contracts for the coming years. Despite this, we still see the company's global commodities operations, including trading operations, carrying higher risk than its European generation portfolio, although we understand that the proprietary trading is very limited.

The company has also reduced its exposure to Russia following the sale of the Russian gas field. However, Uniper still has large generation assets in Russia, and although large part is under capacity payment regimes, we note that most of Uniper's assets receive payments under the "old" capacity scheme (KOM), resulting in lower payments than compared with the "new" scheme (CSA). We also note that Uniper's Berezovskaya plant in Russia will restart operations only in the third quarter of 2019 after a fire in 2016, although this interruption has been mitigated by insurance payments.

Our ratings on Uniper continue to be supported by the company's modest financial risk profile. Following the sale of its 25% stake in Russian gas field Yuzhno Russkoye in December 2017, for a net sum of €1.7 billion, adjusted funds from operations (FFO) to debt improved to 94% in 2017, up from 49% in the transitional year 2016, and adjusted debt to EBITDA was down to 1.0x from 1.7x in 2016. We forecast that Uniper's FFO to debt should be sustainably more than 55% and that adjusted debt to EBITDA would remain at maximum of 1.7x, ratios which we consider as commensurate for the ratings, and which we understand are supported by Uniper's financial policy (economic net debt to EBITDA of below 2x according to Uniper's definition).

In our assessment of Uniper's financial risk profile, we also take into account cash flow after capital expenditures (capex) and dividends in relation to debt to fine-tune our cash flow analysis. This is because we forecast that Uniper will use part of its financial headroom for growing investments and dividends.

In our base case for Uniper, we assume:

- A decline in adjusted EBITDA in 2018-2019 to €1.6 billion-€1.8 billion, compared with the €2.1 billion in 2017, due to loss of EBITDA from disposals and absence of insurance compensation, not fully mitigated by benefits from lower production taxes and increased capacity payments;
- Capex of about €800 million-€1 billion annually; and
- Dividend policy of distributing 75%-100% of free cash flow from operations, with about €270 million paid out to ordinary shareholders in 2018, increasing to about €310 million in 2019.

Based on these assumptions, we arrive at the following credit measures for

Uniper for 2018-2019:

- FFO to debt of about 70%;
- Debt to EBITDA of about 1.2x-1.4x; and
- Broadly neutral cash flow after capex and dividends in 2018-2019.

Liquidity

We assess Uniper's liquidity as strong, since we expect liquidity sources will cover cash uses by more than 1.5x over the next 12 months and by at least 1.0x over the 12 months started Oct. 1, 2017. We also anticipate that sources will cover uses even if EBITDA declined by 30%.

For the 12 months from Jan. 1, 2018, we assume the following liquidity sources:

- Available cash of about €1 billion;
- Available committed facilities of €2.5 billion with a maturity exceeding 12 months; and
- Our projection of operating cash flows (after cash provisions) of about €1 billion.

For the same period, we assume the following liquidity uses:

- The repayment of a €500 million bond in December 2018, and various other financial liabilities of €462 million;
- Capex at approximately €1.0 billion; and
- Dividend payment of about €285 million including minorities.

Uniper's solid relationship with banks and proven access to capital markets further underpins our assessment of its liquidity.

Outlook

The stable outlook reflects our assumption that Uniper's independence, strategy, and financial policy would not materially change due to the likely 47% acquisition by Fortum. We also anticipate that the company will maintain a modest financial risk profile, with adjusted FFO to debt remaining above 55% or adjusted debt to EBITDA of maximum 1.7x.

Downside scenario

We believe that downside risk would be related to signs from new shareholders, including Fortum and the activist funds, of lessening support of Uniper's current strategy and financial policy, leading over time to credit measures below our expectations for the rating. This could include pressure on increased dividends or further growth investments. We could also lower the rating if Fortum acquires a controlling stake in Uniper and reduces the company's independence, leading us to link our rating on Uniper to our stand-alone credit profile (SACP) on Fortum. However, we regard the likelihood of this scenario as low over the next couple of years.

Upside scenario

We believe that upside in the rating is limited, due to our assessment of Uniper's business risk profile, but also to the potential risk of Fortum gradually increasing its shareholding and influence over Uniper in the future, with an uncertain impact on Uniper's SACP.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/--

Business risk: Satisfactory
- Country risk: Low risk
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Modest
- Cash flow/leverage: Modest

Anchor: bbb+

Modifiers
- Diversification/portfolio effect: Neutral (No impact)
- Capital structure: Neutral (No impact)
- Liquidity: Strong (No impact)
- Financial policy: Neutral (No impact)
- Management and governance: Satisfactory (No impact)
- Comparable ratings analysis: Negative (-1 notch)

Stand-alone credit profile: bbb
- Group credit profile: bbb
- Entity status within group: Parent

Issue Ratings--Subordination Risk Analysis

Capital structure

Uniper's financial debt consists primarily of senior unsecured debt at the parent company, but also at the subsidiary level.

Analytical conclusions

The company has sufficiently low leverage, and we see no significant elements of subordination risk in its capital structure. Our issue ratings on Uniper are 'BBB', the same level as the issuer credit rating.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Credit FAQ: The Fortum-Uniper-E.ON Deal And Its Credit Consequences, Feb. 23, 2018

Ratings List

Upgraded

	To	From
Uniper SE		
Issuer Credit Rating	BBB/Stable/--	BBB-/Positive/--
Senior Unsecured	BBB	BBB-

Additional Contact:
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.